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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 30.

THE NATIONAL CITY BANK OF NEW YORK,
Petitioner,

v.

THE REPUBLIC OF CHINA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

STATUTES INVOLVED.

Although petitioner's brief under this heading refers to Section 25-b of the Federal Reserve Act (Title 12, U. S. C. Section 632), the appendix does not set forth the pertinent text of that section but is limited to the first paragraph thereof.

The suit brought by respondent, the National Government of the Republic of China, is to recover a deposit of $200,000 wrongfully withheld by petitioner, The National City Bank of New York, which deposit has been certified by the Department of State, pursuant to the fourth and last paragraphs of Section 25-b of the Act, as belonging to respondent (R. 4-10). That respondent's suit followed

only after petitioner ignored the Secretary of State's certification and that respondent's suit is based on Section 25-b of the Act, is omitted from petitioner's brief, as is the relevant text of that section. Section 25-b of the Act, without limiting in any respect a foreign sovereign's immunity, vests exclusive jurisdiction in the federal courts of a suit by a foreign sovereign against a bank involving bank deposits certified by the Secretary of State as belonging to the foreign sovereign.

We set forth verbatim in the Appendix *infra*, the pertinent text of Section 25-b of the Federal Reserve Act (Title 12, U. S. C. Section 632).

Question Presented.

The abstract question which petitioner poses is not the question presented for review in the terms and circumstances of the case.

This Court should not render what is tantamount to an advisory opinion or general discussion[1] on the extent to which a foreign government which institutes an action in the courts of the United States may rely on the doctrine of sovereign immunity as a defense to counterclaims pleaded against it.

Because this Court will not tolerate suitors maintaining positions here which conflict with those taken below[2], the question before the Court must be viewed in conjunction with the position which petitioner assumed in the Court of Appeals as well as in the District Court.

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[1] This is particularly so in cases involving a sovereign and international law. "In matters of such grave importance as those involving questions of international law it seems to me very expedient that Courts should refrain from expressing opinions which are beside the question actually to be decided." *Compania Naviera Vascongada* v. *S.S. Cristina*, 1938 A. C. 485, 493.

[2] *Seney* v. *Swift & Co.*, 260 U. S. 146, 149.

A substantial portion of petitioner's brief is devoted to its contentions relating to the question, which this Court is asked to pass upon, whether the subject matter of the counterclaims, although involving public funds, are commercial transactions within the "restrictive theory" of sovereign immunity and, if so, whether the decisions of some foreign nations accepting that restrictive theory denying sovereign immunity to activities connected with commercial enterprises and which was referred to by our State Department in a letter of May 19, 1952, should be followed by this Court.

Not only are petitioner's contentions in regard to this asserted question meritless, but also petitioner's position is contrary to the position it took in the Court of Appeals. Thus, petitioner is requesting this Court to pass upon a question which it deliberately removed from the Court of Appeals' consideration. In that court, petitioner conceded that the counterclaims dealt with public or governmental functions and that even within this restrictive theory respondent would be entitled to plead sovereign immunity to the causes of actions alleged in the counterclaims. This is more fully discussed in Point IV, page 35, *infra*. Petitioner should not be permitted to reverse its position in this Court and the asserted question presented by the petitioner relating to the restrictive theory of sovereign immunity should be disregarded.

In addition, the counterclaims pleaded by petitioner in the District Court explicitly demanded judgment "against the plaintiff, The Republic of China, for the sum of one million, six hundred thirty-four thousand, four hundred thirty-two and no dollars ($1,634,432.00) with interest and costs" (R. 26-27). Petitioner before the District Court argued it was entitled to affirmative judgment and it was these counterclaims demanding affirmative judgment

for $1,634,432.00 which the District Court passed upon (R. 36). In this Court, however, petitioner withdraws its demand for affirmative judgment.[3]

By this withdrawal, petitioner has rendered moot any question relating to the propriety of the order dismissing the counterclaims which demanded affirmative relief. Petitioner concedes that it is not entitled to affirmative relief against respondent (Petitioner's brief p. 11, f. n. 1). But, more important, it really doesn't matter whether the order dismissing the counterclaims demanding affirmative judgment against respondent for $1,634,432 is correct or incorrect, for petitioner, by withdrawing its demand, now has removed these particular counterclaims from the case.[4] We submit, therefore, that so far as the order dismissing these counterclaims is concerned, it is not involved in the question presented.

This would only leave for the Court's proper consideration the subsequent order which denied that part of petitioner's motion seeking leave to serve a further amended answer designating the counterclaims also as set-offs[5]

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[3] Petitioner states: "The City Bank does not seek an affirmative judgment against The Republic of China, but raises the counterclaims merely as a defense to the action" (Petitioner's brief, p. 11).

[4] Surely petitioner does not contend that its counterclaims even before the District Court were raised "merely as a defense to the action", as they are now asserting in this Court. If that were the case, the lower court's order "dismissing" them would be nothing more than an order striking the defenses. Such an order would clearly be a non-final one from which no appeal would lie (*Libbey-Owens-Ford Glass Co.* v. *Sylvania Indust. Corp.*, 154 F. (2) 814), irrespective of any statement contained therein that entry of judgment is directed in accordance with Rule 54-b of the Federal Rules of Civil Procedure. See 6 Moore's *Federal Practice* (3rd Ed. 1953) pp. 286-287, fn. 10, 11, 12.

[5] Petitioner's motion to serve a further amended answer was combined with a motion for reargument wherein it attempted once more to sustain the counterclaims demanding affirmative relief. (R. 46-49).

(R. 57, 72). Actually, designation of the counterclaims also as "set-offs" was unnecessary under Rule 13 of the Federal Rules which denominates as "counterclaims" all claims brought by a defendant against a plaintiff. Moreover, merely to have designated the counterclaims also as set-offs would not have affected petitioner's demand for affirmative relief, because a set-off is not necessarily confined to the justice of a plaintiff's claim and an affirmative judgment may be had for any amount to which defendant establishes his right over and above the amount to which plaintiff proves he is entitled.[6] It seems clear, therefore, that even with respect to the second order the District Court's ruling concerned counterclaims, however designated, which counterclaims petitioner has now removed from the case.

Only if it be assumed, therefore, that petitioner's motion to the District Court can be construed as a request to serve a further amended answer pleading the context of the dismissed counterclaims as defenses in the nature of set-offs with no affirmative relief demanded, is there any proper question presented for review by this Court; provided it be further assumed that such an order was appealable, which, we submit, it was not.[7] Moreover, the factual assumption is unwarranted, for petitioner at no time requested the District Court to treat the counterclaims or set-offs except as demanding affirmative relief.

Even on the basis of these assumptions, however, the question presented, based on the facts and circumstances of the case, should be stated as follows:

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[6] *Penn. Rr. Co.* v. *Miller*, 124 F. (2) 160, cert. denied 316 U. S. 676.

[7] *Hancock Oil Co.* v. *Universal Products Co.*, 120 F. (2) 959, 960, cert. denied 314 U. S. 666.

Accepting petitioner's position in the Court of Appeals, that its proposed defenses in the nature of set-offs based on alleged Treasury notes of respondent relate to governmental functions and that the restrictive theory of sovereign immunity even if followed by the Court would not serve to deprive respondent of its sovereign immunity, was petitioner's motion, seeking leave to serve a further amended answer pleading said defenses in the nature of set-offs to respondent's suit predicated on Section 25-b of the Federal Reserve Act, properly denied.

Statement.

On December 3, 1948, when for reasons now a matter of history, it became important to transfer government funds out of the mainland of China, respondent, through its agency, The Shanghai-Nanking Railway Administration, requested petitioner's Shanghai office to accept a substantial deposit to be opened at petitioner's New York office in the name of respondent's agency (R. 13). Petitioner agreed to accept this deposit and on December 21, 1948 an account was established at petitioner's New York office in the amount of $200,000 in the name of respondent's agency, The Shanghai-Nanking Railway Administration (R. 13).

At the time petitioner was solicited to accept this deposit, the notes upon which petitioner bases its counterclaims were in existence and, according to petitioner, respondent was already in default on those obligations (R. 24-26).

Petitioner recognized that those obligations were to be treated as distinct and separate from the contemplated bank account, as is evidenced by petitioner's allegations that no debit of any kind has been made to the account except for a $7.50 service charge, and that the account is

now in credit of $199,992.50 (R. 13-14). Indeed, for petitioner to have lulled respondent into opening the account intending to use the funds in satisfaction of separate outstanding obligations already in default would hardly be consistent with the principles of fair-play espoused so vigorously in petitioner's brief.

After respondent's National Government became located in Taiwan (Formosa), respondent, being in urgent need of the funds to carry out governmental functions, made several demands upon petitioner for payment to it of the $200,000 bank deposit. One of these demands is contained in a letter dated August 25, 1949 (R. 27-28), made more than five years ago.

In accordance with petitioner's request contained in a letter of August 31, 1949 addressed to the Chinese Embassy at Washington, D. C. advising it that because of conflicting claims made on petitioner with respect to the account respondent "should take up the matter directly with the State Department in Washington and ascertain its views as to the establishment of the proper authority to deal with this account", respondent applied to the Secretary of State and on August 21, 1950 the Secretary of State, pursuant to Section 25(b) of the Federal Reserve Act (Title 12, U. S. C. Section 632), certified to petitioner that the deposit in question belongs to respondent (R. 8, 11).

Although the express provisions of Section 25(b) exonerate petitioner from all further liability once it honors the certification made by the Secretary of State, petitioner refused to comply with the certificate, but instead asserted that there are other adverse claims to the bank deposit in question, obviously made on behalf of the communist Chinese regime which is not recognized by the United States.

At no time prior to the service of its amended answer on July 11, 1952 did petitioner refuse payment of the account for any reason other than the alleged existence of adverse claimants. On October 18, 1950 and also on August 24, 1950 respondent, complying with the certificate from the Secretary of State, presented a check for payment to petitioner for the full amount of the deposit (R. 15) and on each occasion the check was returned with the notation that payment was refused because other persons claimed authority to collect the funds.

After the certificate from the State Department was obtained as petitioner requested in its letter of August 31, 1949 and petitioner continued in its refusal to pay the deposit to respondent, it became obvious that petitioner was determined not to pay the funds to respondent,[8] with the result that the only course open to respondent was to bring suit to enforce the certificate issued by the Secretary of State pursuant to Section 25-b of the Federal Reserve Act (Title 12 U. S. C. Section 632).

Accordingly, on May 2, 1951 suit was commenced in the United States District Court, Southern District of New York to recover the $200,000 deposit (R. 1, 4). This was more than three years ago, but respondent still is not in possession of these funds.

Before filing an answer and on the sole ground that adverse claims had been presented with respect to the account, petitioner succeeded in staying respondent's suit for one year in order to give notice, pursuant to New York Civil Practice Act §51-a, to the alleged adverse claimants

[8] In its amended answer petitioner specifically denies that respondent has authority to collect the bank deposit (R. 16) and in one of its affirmative defenses it pleads that the hostilities as a result of which respondent was driven from China was a civil war and that it is contrary to United States policy to favor the recognized government over the revolutionary government (R. 19-20).

in Peking and in Shanghai, China, advising them that, unless they brought suit on the deposit in question before the one-year stay expired, their causes of action would be time-barred in New York under that statute.

On March 14, 1952, before the one-year stay expired, petitioner served its answer, wherein no counterclaim or set-off of any kind was pleaded (R. 1).

After the one-year stay had been obtained and the notice had been served on the alleged adverse claimants representing the communist regime, a separate suit was started against petitioner in the Southern District of New York on behalf of the Chinese communist regime by the Nanking-Shanghai Railway Administration, K. F. Mok and Y. T. Yu (Civ. No. 77-1/1952). However, on December 3, 1952, petitioner entered into a stipulation permitting those alleged adverse claimants to discontinue the suit, the stipulation reciting that the parties were remitted to such rights, powers, privileges and immunities as each may have in respect to the other as though the suit had not been commenced.

On July 11, 1952, prior to the signing of that stipulation, petitioner served an amended answer herein setting forth two counterclaims and demanding judgment against "The Republic of China for the sum of one million, six hundred thirty four thousand, four hundred thirty two and no/100 dollars ($1,634,432.00) with interest and costs" (R. 26-27).

Both of the counterclaims arose out of transactions completely unrelated to the bank deposit for which respondent sues.

The first counterclaim was based on a Treasury note, payable at The Chase National Bank (R. 53) and purchased by J. P. Morgan & Co. (R. 24) allegedly on behalf of a syndicate in which petitioner claims a participating interest (R. 24).

Its second counterclaim was based on Treasury notes allegedly purchased by the Shanghai foreign branch of petitioner in 1947 and in 1948, payable at The Central Bank of China (R. 25).

Respondent's motion (R. 34) to dismiss the counterclaims which sought affirmative relief was granted with an opinion by Judge Irving R. Kaufman, of the Southern District of New York (R. 35, 41). Petitioner's subsequent motion for reargument and for leave to file an amended answer designating the counterclaims also as set-offs (R. 46), was denied also with an opinion by the District Court (R. 55, 57). On appeal taken by petitioners from both orders (R. 42, 58), the Court of Appeals for the Second Circuit, in an unanimous opinion written by Judge Frank and joined in by Judge Swan and Judge Medina (R. 64), affirmed both orders (R. 72). On April 26, 1954 this Court allowed certiorari, Mr. Justice Jackson taking no part in the consideration or decision of the application (R. 73).

Summary of Argument.

1. The writ should be dismissed as improvidently granted. None of petitioner's contentions are dispositive of the case because they presuppose that the counterclaims actually pleaded and dismissed did not seek affirmative judgment and were therefore valid in themselves as mere defenses in the way of set-offs. But the counterclaims dismissed did demand affirmative judgment for $1,634,432, with interest and costs (R. 26-27), and it was these counterclaims demanding affirmative judgment which the District Court passed upon in its first order dismissing the counterclaims (R. 36), and in its second order denying petitioner's leave to make an unnecessary amendment to the counterclaims which still demanded affirmative relief (R. 57). Petitioner, by withdrawing in this Court its demand for

affirmative judgment (Petitioner's brief p. 11), has rendered moot any question as to the correctness of the lower court's order precluding it from demanding affirmative relief, something which it no longer seeks. Moreover, if the orders be treated as involving mere defenses and not counterclaims, they were not appealable.

2. But if this Court is disposed to review petitioner's contentions, we submit the proposed defenses in the nature of set-offs are clearly not maintainable against respondent, a friendly foreign sovereign, which is not subject to suit, directly or indirectly, without its consent. The cases, including pronouncements by this Court, which state this doctrine are legion.

3. The decisions relied on by petitioner, holding that where the United States brings a suit the defendant may set-off any claim it has, are clearly distinguishable, since they are based upon the specific consent of the United States contained in a statute that such set-offs may be pleaded against it.

4. Congress, fully familiar with the principles of sovereign immunity, vested the federal courts with exclusive jurisdiction of claims by a foreign sovereign against a national bank involving bank deposits certified by the Secretary of State as belonging to the sovereign, but Congress went no further. If Congress had desired, it could have effectively provided, just as it had done in legislating on suits brought by the United States, that in such a proceeding by a foreign sovereign all credits could be taken by the bank, or merely certain types of credits arising from jure gestionis (thereby adopting the restrictive theory). Congress could amend Section 25-b of the Federal Reserve Act so that, in exchange for the Secretary of State's certificate and the other benefits, a sovereign which avails itself

of the Act would be deprived of so much of its immunity as Congress desired. But it is for Congress to make this change, not for the courts.

5. "The Draft Convention of Courts in Regard to Foreign States", resulting from the research conducted by Harvard University in 1932, (hereinafter referred to as the "Harvard Draft Convention"), which goes far beyond established precedents in suggesting limitations on the general doctrine of sovereign immunity, is yet careful to preserve to sovereigns full immunity with respect to counterclaims or set-offs arising out of transactions extrinsic to those upon which a sovereign plaintiff's claim is based.

6. Where a sovereign institutes an action it subjects itself to the procedure and rules of decision governing the forum it has sought only so far as they are applicable to the particular cause of action which is the subject matter of the suit. That is to say, once the consent to litigate a particular claim is obtained, then the rules of the forum governing the procedure to enforce that claim apply. But the rules of procedure cannot be relied upon to furnish in the first instance a sovereign's consent to litigate a claim or to make an otherwise unenforceable claim enforceable.

7. This does not result in rendering a defendant who has been sued by a sovereign "defenseless", as is suggested by petitioner, for no rule of immunity has ever been extended to deprive a defendant of a legal defense to the cause of action sued upon.

8. A claim in the nature of recoupment has always been permitted against a sovereign regardless of consent, because recoupment goes to the justice of plaintiff's claim and is a true defense permitting a defendant to reduce a plaintiff's recovery by showing facts arising out of the same trans-

action sued upon which establish that plaintiff's damages were really not as high as alleged.

9. On the other hand a set-off, as this Court itself has declared, has never been extended to suits between governments and individuals, in the absence of express consent of the sovereign. This is for the reason that a set-off does not relate to the justice of the particular claim in suit; it permits a defendant to raise claims arising out of transactions independent of those sued upon, and it is therefore not a true defense to the claim in suit. In short, the indirect or permissive counterclaim, which includes set-offs, must be tested as if it were an independent suit, and unless the sovereign has consented to be sued thereon, it is not maintainable.

10. The questions raised by petitioner's contentions based on the restrictive theory of sovereign immunity should be disregarded by the Court because of the contrary position taken by petitioner in the Court of Appeals.

11. In any event, the doctrine is squarely opposed to previous decisions of this Court where the same argument that immunity should be limited to governmental functions as distinguished from commercial activities was advanced and rejected.

12. There are numerous countries who have refused to follow the restrictive theory of immunity.[9] As Mr. Tate's letter indicates, there are at least sixteen countries, includ-

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[9] The bulk of decisions by civil law countries, some of which are cited in petitioner's brief, together with the many contrary decisions, will be found collected and discussed in the Department of State's treatise, prepared by Mr. Conrad E. Snow, Chairman, submitted to the members of the Legal Adviser's Committee on Sovereign Immunity, dated August 25, 1949, and entitled "The Law of Sovereign Immunity".

ing the United States and the British Commonwealth, who have not applied the restrictive theory of immunity, as opposed to possibly eleven civil law countries that have followed it. Decisions of civil law countries adopting the theory of restrictive immunity have existed for many decades and have been brought to the attention of this Court, which has refused to follow them.

13. The general doctrine of sovereign immunity is so embedded in our law that it cannot be uprooted by judicial decision or by the State Department's shift of policy, but any change in the substantive law should be effected by Congress or by treaty. Indeed, the State Department recognizes that "its shift in policy" cannot control the courts. In the past, where it has sought to exclude commercial activities from sovereign, it has done so by treaty (Petitioner's brief pp. 44-46.) Significantly, no such treaty has been executed with respondent.

14. This Court long ago declared that international comity requires that foreign governments be notified of any modification of immunity "in a manner not to be misunderstood" before the modification be effected. Obviously to overrule previous decisions, thereby giving a retroactive effect to the modification, will not comply with this rule.

15. Even accepting the so-called trend or shift in policy expressed in Mr. Tate's letter, the sovereign still remains immune to claims arising from public or governmental transactions as distinguished from commercial activities. The counterclaims here involved, dealing with the Government's Treasury Notes, fall within that category, for what could be considered more "governmental" in nature than the fiscal operations of a sovereign and the bonds or other obligations it issues to raise revenue upon which its very existence depends.

16. The courts consistently have held that debts due from a foreign nation cannot be enforced in the courts of the creditor nation, and that principle is explicitly adopted by the Harvard Draft Convention. Although the Harvard Draft Convention adopts the restrictive theory of immunity, it specifically provides that a sovereign cannot be compelled to litigate matters relating to its public debt, which it defines to include Treasury notes, such as are involved in the counterclaims herein.

POINT I.

THE WRIT OF CERTIORARI SHOULD BE DISMISSED AS IMPROVIDENTLY GRANTED.

If we are correct in our position that the only relief sought by petitioner and denied him by the District Court concerned counterclaims—whether designated set-offs or otherwise—demanding affirmative judgment against respondent (ante pp. 2-7), then there is nothing for this Court to review, since petitioner, by here withdrawing its claim for affirmative judgment, renders moot any question relating to the propriety of the orders of the District Court.

This seems indisputable with respect to the first order of the District Court, which unquestionably dismissed counterclaims demanding affirmative relief (R. 26-27, 36). This seems equally clear with respect to the second order, which denied petitioner leave to amend the dismissed counterclaims so as to designate them also as set-offs, because the requested leave would not have affected petitioner's demand for affirmative judgment[10] and indeed peti-

[10] Under a "set-off" an affirmative judgment may be had for any amount defendant establishes his right over and above the amount to which plaintiff proves he is entitled. *Penn. Rr. Co.* v. *Miller*, 124 F. (2) 160, cited *supra*, f. n. 6.

tioner in the District Court persisted in its demand for affirmative judgment. Petitioner cannot complain that it was improperly denied leave to plead the counterclaims as defenses in the nature of set-offs without affirmative relief, when it never made any such application.

But even if it be assumed that petitioner's motion for leave to serve an amended answer to designate the dismissed counterclaims also as set-offs was broad enough to have included a request to plead the context of the counterclaims as defenses in the nature of set-offs without seeking affirmative relief, and further that the order denying such relief was ~~applicable~~ appealable[11], the writ should nevertheless be dismissed because in those circumstances none of the contentions made by petitioner are decisive of the case (*McCarthy et al.* v. *Brunner*, 323 U. S. 673).

Assuming arguendo that petitioner did request such relief, that the order was appealable, and that the proposed defenses in the nature of set-offs are legally sustainable, yet the granting or denial of the motion to serve a third[12] answer was in the discretion of the lower court and the exercise of that discretion should not be reviewed here.

Moreover, the denial of the motion by the court because of untimeliness was legally sound. Petitioner's motion sought specifically to amend the counterclaims which already had been dismissed and this could not be granted until the judgment of dismissal was first reopened. As the lower court stated (R. 56-57), relief of that nature is to be applied for within ten days after the entry of the judgment (Rule 59 of the Federal Rules; *Markert* v. *Swift & Co.*, 173

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[11] As to appealability, see p. 5, *supra*, f. n. 7.

[12] Petitioner's original answer which contained no counterclaims or set-offs of any kind was served on March 14, 1952 (R. 1); by stipulation and order it served an amended answer on July 11, 1952 (R. 2); its application to serve a further amended answer, if granted, would have been the third answer.

F. (2) 517, 519), whereas petitioner's motion was made thirteen days after judgment was filed.

In addition, the Court should not prematurely pass upon the validity of defenses before the cause of action sued upon is determined, for unless respondent sustains its claim, the issues raised by the defenses will not be reached.

POINT II.

A COUNTERCLAIM ARISING FROM TRANSACTIONS EXTRINSIC TO THAT OUT OF WHICH THE PRIMARY CLAIM AROSE IS THE EQUIVALENT OF AN INDEPENDENT SUIT AGAINST THE SOVEREIGN WHICH MAY NOT BE SUED WITHOUT ITS CONSENT.

The Doctrine of Sovereign Immunity.

There can be no question that the basic doctrine of sovereign immunity is an integral part of Anglo-American law.[13] Indeed, it is an unquestioned part of the law of most civilized nations.[14] Historically, the doctrine appears to be founded on the implied agreement of the local sovereign to yield local jurisdiction as a matter of international comity and as an indispensable factor to the conduct of friendly intercourse between nations[15], as well as upon the principle that as a consequence of state equality, no state

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[13] *The Schooner Exchange* v. *McFadden*, 7 Cranch 116; *The Parlement Belge*, (1880) L. R. 5 P. D. 197; 1 Hyde on International Law 813; 1 Oppenheim's International Law 239-241.

[14] This is nowise disputed by Mr. Tate's letter of May 19, 1952 wherein the existence of the basic doctrine is conceded. At p. 1 of the State Department's treatise on "The Law of Sovereign Immunity" (referred to *supra*, f. n. 9) the following is said: "Formulated in earlier times by classical writers, the principle has been endowed since the beginning of the 19th Century with the certainty and definiteness of concordant and authoritative decisions of municipal courts in the majority of the states of the world."

[15] *The Schooner Exchange* v. *McFadden*, 7 Cranch 116, *supra*, f. n. 13.

can exercise jurisdiction over another[16]. The latter principle is explicitly affirmed by Article 2(2) of the United Nations, which declares that the United Nations Organization is based upon "the sovereign equality of its members".

Irrespective of the genesis of the doctrine, we submit it is a far from hoary one. It has a fundamental and sound basis which is just as important today as it ever was, viz., that a sovereign which represents all of its people must itself decide when it will consent to litigate a claim by one seeking to satisfy only his own selfish interests without regard to the interests of all of the people and without regard to the continued existence of the very sovereign involved.[17] Concededly, litigation in some instances will not drastically affect the people or the continued existence of the sovereign. But this is something which the sovereign alone can determine, and in the absence of its consent to be sued, its plea of immunity should be respected, with the claimant being relegated to pursuing relief through diplomatic channels where the primary interests of the people and of the sovereign can be balanced against the merit of the claim. The doctrine is so entrenched in the decisions and in international law that one dealing with a foreign sovereign, which has not by treaty, declaration or otherwise consented to be sued on the transaction involved, must be deemed to have accepted as an integral part of his dealings the condition that, in the event a claim in favor of the individual arises, it cannot be litigated but must be resolved

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[16] *The Roserie*, 254 Fed. 154, 161.

[17] *U. S.* v. *Lee*, 106 U. S. 196, 206, where the court points out that to permit a sovereign to be sued would constitute a serious interference with the performance of the sovereign's functions and with its control over its instrumentalities, funds and properties; *Ex Parte State of New York, No. 2*, 256 U. S. 503, 511, where the Court observed to permit a creditor to collect his debt would be to permit him in some degree to destroy the government itself.

through diplomatic channels.[18] While the risk of default under such a condition may perhaps be greater than where two individuals are involved, yet there is no compulsion in the dealings between the individual and the sovereign, but the individual must be considered voluntarily to have accepted the risk as counterbalanced by the advantages he expects to derive from the transaction.[19]

At all events, it seems clear that the doctrine is now an accepted and well-recognized rule in the United States[20] and in most other countries[21]. Although some have stated that the doctrine should be limited, there has never been any serious suggestion that the doctrine should or can be discarded. Accordingly, we pass over quickly petitioner's contention that the doctrine should be abrogated in its entirety, and we turn to the question of whether a plea of immunity precludes a defendant, against whom the sovereign has instituted suit, from asserting a counterclaim or set-off which is unrelated to the subject matter of the main suit.

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[18] *Ex Parte Peru*, 318 U. S. 578 at p. 589: "* * * our national interest will be better served in such cases if the wrongs to suitors, involving our relations with a friendly foreign power, are righted through diplomatic negotiations rather than by compulsions of judicial proceedings."; *Wulfsohn* v. *Russian Republic*, 234 N. Y. 372, 375-376.

[19] See, for example, the 20% annual interest rate on the Treasury Notes referred to in petitioner's second counterclaim (R. 33).

[20] So far as the doctrine applies to suits against the States of the Union by other citizens of the United States or of foreign states, it is ingrained in the Federal Constitution itself. See U. S. Constit. Amend. XI.

[21] The doctrine is followed with no limitations by the Chinese Courts. See *Freres* v. *The Soviet Mercantile Fleet*, Jr. Du. Dr. Int. 1928, 1104, discussed on the last page of the State Department's treatise "The Law of Sovereign Immunity" (*supra*, f. n. 9).

A friendly foreign sovereign is not subject to suit, directly or indirectly, without its consent.

In *Commonwealth* v. *Matlack*, 4 Dall. 303, this Court declared:

> "* * * that the defendant could not indirectly recover from the state a substantive independent claim by way of set-off, any more than he could directly recover a debt due from the state, by bringing a suit against her."

And in *Watkins* v. *U. S.*, 9 Wall. 759, it was said (at p. 764):

> "The right of set-off did not exist at common law, but is founded on the statute of 2 George II, c. 24, s. 4, which in substance and effect provided that where there were mutual debts between the plaintiff and the defendant, one debt may be set against the other, and such matter may be given in evidence under the general issue. Set-offs might even after the passage of that act, be made, in a proper case, between plaintiff and defendant, but it never extended to suits between government and individuals, * * *"

And again in *Nassau Smelting & Refining Works* v. *U. S.*, 266 U. S. 101 (at p. 106):

> "The objection to a suit against the United States is fundamental, whether it be in the form of an original action or a set-off or a counterclaim. Jurisdiction in either case does not exist, unless there is specific congressional authority for it."

This principle was reaffirmed in *U. S.* v. *Shaw*, 309 U. S. 495, 502 where this Court reviewed the cases on the subject and commented that only when authorized by specific

Congressional statute can a set off or counterclaim or an original suit be brought against the United States.

In *Berryessa Cattle Co.* v. *Sunset Pacific Oil Co.*, 87 F(2) 972 (a decision cited by this Court in *Great Northern Ins. Co.* v. *Read*, 322 U. S. 47 at p. 50 f. n. 3), the Court of Appeals agreed with appellee's contention "that there is no right to set-off in this case because the exercise of such a right is inconsistent with the right of a sovereign state not to be sued without its consent" (87 F(2) at p. 974). The Court of Appeals quoted with approval the following language from *People* v. *Mills*, 56 Cal. 401: "It would seem to be hardly necessary to cite authorities to the proposition, that a State cannot be sued in her own State, directly or indirectly, as by setting up a counterclaim or set-off; nor can any judgment be recovered against the State, except when the same is permitted by express statute."[22]

Professor Moore, in 3 Moore's Federal Practice (3rd Ed. 1953) Par. 13, 15 [2], at pages 42-43, speaking of the effect of sovereign immunity on the jurisdiction of a federal court to entertain a counterclaim against a sovereign plaintiff, says:

> "But the power to entertain a claim against a sovereign is circumscribed by the general principles of immunity * * * The mere institution of suit does not constitute a waiver of immunity by the plaintiff sovereign. Such plaintiff is, however, subject to a

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[22] See also *South African Republic* v. *La Compagnie Franco-Belge*, (1898) 1 Ch. 190; *Kingdom of Roumania* v. *Guaranty Trust Company*, 250 Fed. 341, 343-344, cert. denied 246 U. S. 663 (cited in *Monaco* v. *Mississippi*, 292 U. S. 313, 323 f. n. 2); *In re Patterson-MacDonald Shipbuilding Co.*, 293 Fed. 190, cert. denied 264 U. S. 698; *Re Monongahela Rye Liquors*, 141 F(2) 864; *U. S.* v. *Hosteen Tse-Kesi*, 191 F(2) 518, 521; *Republic of China* v. *American Express Co.*, 195 F(2) 230, 233; *In re Greenstreet, Inc.*, 209 F(2) 660, 663; *U. S.* v. *Wessel, Duval & Co.*, 115 F. Supp. 678, 686-687; *U. S.* v. *Lacy*, 116 F. Supp. 15, 21.

> counterclaim setting forth matter of recoupment for the purpose of defeating or diminishing the plaintiff's recovery but not for the purpose of an affirmative judgment against the sovereign unless there is some authorization therefor in addition to the institution of the action. Unless the law of the sovereign plaintiff, or some other law paramount to its own, such as the Bankruptcy Act, permits a set-off against its claim and this set-off to be asserted in the federal court where the action is pending, then there would be no right of set-off. An affirmative judgment cannot be obtained against the plaintiff sovereign on either a compulsory or permissive counterclaim absent its consent to be sued on the type of claim involved and in the federal court where the counterclaim is asserted."

Thus, while under Rule 13 of the Federal Rules the distinction between recoupment and set-off is unimportant so far as designation is concerned, yet the distinction remains important so far as determining whether the claim may be pleaded against a sovereign.

Recoupment as Opposed to Set-Off.

A claim in the nature of recoupment has always been permitted against a sovereign regardless of consent[23], because recoupment goes to the justice of the plaintiff's claim and is a true defense, permitting the defendant to reduce plaintiff's recovery by showing facts arising out of the transaction sued upon which establish that plaintiff's damages were really not as high as alleged.

That recoupment is a true defense is demonstrated by the decisions holding that it is allowable against a sov-

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[23] *U. S.* v. *U. S. F. & G. Co.*, 309 U. S. 506; *U. S.* v. *Wessel, Duval & Co.*, 115 F. Supp. 678, 686-687.

ereign even though the statute of limitations has expired on the claim recouped. Contrary to petitioner's assertion, this Court in *Bull* v. *U. S.*, 295 U. S. 247, authoritatively determined that, where there is no specific consent by the sovereign to a counterclaim, it may be pleaded only by way of recoupment. There was no statute or other independent consent of the sovereign which could have been relied upon, for the claim raised by defendant had been outlawed by the statute of limitations and therefore the act of Congress[24] which permitted a credit to be pleaded by a defendant was inapplicable. Nonetheless, the claim was allowed because it was in the nature of recoupment and was pleadable against a sovereign plaintiff without regard to consent.[25]

Petitioner's attempt to minimize the *Bull* case by citing *U. S.* v. *Ringgold*, 8 Pet. 150, for the asserted proposition that there is no limit to the type of claim that can be asserted as a defense to a suit by the United States, ignores that in the *Ringgold* case decided in 1884 the defendant had the benefit of the specific statutory consent of the Government[26] which permits set-offs of any kind whether or not related to the main suit.

Indeed, petitioner's reliance upon those decisions which have permitted set-offs against the United States pursuant to that statute, serves only to defeat its argument that a sovereign merely by becoming a plaintiff surrenders its immunity to suit. The United States in its sovereign capacity by specific legislation has consented to set-offs of any nature, and only because of its explicit consent are they

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[24] Act of March 3, 1797, Sess. II Chap. XX, now found in 28 U. S. C. §2406.

[25] Cf. *Rothensies* v. *Electric Battery Co.*, 329 U. S. 296, 299, where the outlawed claim pleaded against the Government was unrelated to the main suit and, therefore, disallowed.

[26] Act of March 3, 1797, Sess. II Chap. XX, cited *supra*, f. n. 24.

pleadable.[27] Where the terms of the statute are not complied with (*Hall* v. *U. S.*, 91 U. S. 559), or where there is no statute which approves the set-off (*U. S.* v. *Buchanan*, 8 How. 83), the United States' defense of sovereign immunity has been upheld. The decisions cited by petitioner are, therefore, clearly inapplicable, since the set-offs therein permitted against the United States were pursuant to statutory authority of the sovereign, which is wholly lacking here.

Petitioner does not urge that if the United States brought suit in a foreign court it would be subject to set-offs in that forum, for the statutory consent which applies to courts of the United States would not be applicable to foreign courts. Similarly, respondent has not consented by declaration or otherwise that set-offs on independent claims be allowed against it in courts outside of its territory.

In addition, Congress, fully familiar with the principles of sovereign immunity, vested the federal courts with exclusive jurisdiction of claims by a foreign sovereign against a national bank involving bank deposits certified by the Secretary of State as belonging to the sovereign, but Congress went no further. Congress, having provided foreign sovereigns with special benefits in bank deposit cases, could have, and by amendment of the Act may still, limit it in any way it desires. But it is for Congress to do so, not for the courts.

A Set-Off Is the Equivalent of an Independent Proceeding Requiring the Sovereign's Separate Consent Thereto.

Whereas recoupment goes to the justice of a plaintiff's claim, a set-off does not go to the justice of that particular

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[27] For discussion of counterclaims and offsets involving the United States, see 3 Moore's Federal Practice (3 Ed. 1953), pp. 66-82.

claim because it arises from acts or transactions independent and separate from the claim sued upon.[28] In short, a counterclaim or set-off arising out of a transaction extrinsic to that out of which the primary claim arose, is the *equivalent of an independent suit against the sovereign,* which may not be sued without its consent. This was made clear in *Re Monongahela Rye Liquors,* 141 F. (2) 864 where the court explained the significance in suits by sovereigns of Rule 13-b of the Federal Rules of Civil Procedure allowing permissive counterclaims. We quote from the court's opinion (p. 869):

> "A distinguishing feature of set-off is that it arises out of a transaction extrinsic to that out of which the primary claim arose. Cv. Hastorf *v.* Degnon-McLean Contracting Co., D. C. N. Y., 128 F. 982, 983. In short, a set-off rests upon a claim or demand based upon an independent cause of action. The independent nature of set-off is plainly recognized by the Federal Rules of Procedure. Thus, Rule 13(b) allows for the assertion of set-offs as 'Permissive Counterclaims'. But, unlike in the instance of a true counterclaim, i.e., a claim or demand arising out of the same transaction which gave rise to the primary claim and which must be asserted timely as a counterclaim (Rule 13(a)), failure to plead a set-off as a counterclaim does not defeat the right of action upon which it is based. The present importance of the distinction between a counterclaim and a set-off lies in the fact that, under both federal and local law, in a suit by a sovereign a plea of set-off, being based as it is upon matter unrelated to the primary claim, is the equivalent of an independent suit against the sovereign which, of course, may not be sued without its consent. See Nassau Smelting & Refining Works, Ltd. *v.* United States, 266 U. S. 101,

[28] *Penn Rr. Co. v. Miller,* 124 F. (2) 160, cert. denied 316 U. S. 676.

106, 45 S. Ct. 25, 69 L. Ed. 190; Commonwealth *v.* Matlack, 4 Dall, Pa. 303, 1 L. Ed. 843."

The above principles are in complete accord with The Harvard Draft Convention.[29] Article 5 of that Draft Convention provides: "A complainant State, by instituting a proceeding in a court of another State, submits to the jurisdiction of that court in respect of a direct counterclaim." Article 6 provides: "A complainant State, by instituting a proceeding in a court of another State, submits to the jurisdiction of that court in respect of an indirect counterclaim only if that counterclaim is one for which the respondent could maintain an independent proceeding in that court against the complainant State."

The pertinent words used in these Articles are defined in Article 1. "Counterclaim" is defined as "a claim by a respondent against a complainant" (Article 1(e)). A "direct counterclaim" is defined as "a counterclaim arising out of the facts or transactions upon which a complainant's claim is based" (Article 1(f)). An "indirect counterclaim" is defined as "a counterclaim arising out of the facts or transactions extrinsic to those upon which a complainant's claim is based" (Article 1(g)).

In the comment to Article 1(e), (f) and (g) it is recognized that various meanings have been ascribed to the terms "counterclaim", "set-off" and "recoupment", and it is there stated (Am. J. of Intern. Law Supp. (1932) at p. 492):

> "For the purpose of this Convention, the factual distinction represented by the terms 'recoupment' and 'set-off', seems to be one which it is useful to preserve. It is not a question of abandoning a fixed terminology, since none exists. A new term of art

[29] For complete text of this Draft Convention see American Journal of International Law, 1932, Vol. 26 Supplement pp. 451-736.

may therefore be created. For this purpose, it would be possible to speak of 'Counterclaims, Class A,' and 'Counterclaims, Class B.' Less awkward and more descriptive terms have been used in the text, namely, 'direct counterclaims' and 'indirect counterclaims.' "

Speaking of indirect counterclaims, the comment continues (Am. J. of Intern. Law Supp. (1932), at pp. 517-518):

"Thus the Article does not afford a new basis for jurisdiction over a State; it merely permits the consolidation of actions if the law of the forum so provides. It is obvious that the stipulation of submission to the jurisdiction herein set forth would not require a court to admit the indirect counterclaim if under the law of the forum such a counterclaim would not be admitted against a private complainant. This article merely has the effect of raising the bar of state immunity when, according to the applicable procedure, it is pertinent to examine into that immunity.

"Thus if State X institutes in a court of State Y a proceeding against A to recover damages for breach of a contract to sell locomotives, State X thereby submits to the jurisdiction of the court in respect of a counterclaim by A arising out of a lease of immovable property (Article 9). If under the law of the forum such an indirect counterclaim is not admissible, A's counterclaim will be rejected by the court on that ground but not on the ground of the immunity of State X.

"In the second place, this article assures a complainant State that by instituting a proceeding in a court of another State, it will not be forced to respond to an indirect counterclaim for which an independent action could not be maintained by the respondent against the complainant State. For example, if State X institutes a proceeding against

> A in a court of State Y, for breach of a contract to sell wheat, A would not be able in the same proceeding to adjudicate a claim which he might have against State X for injuries received from the negligent operation of a mail truck operated by an agent of State X. Under the procedural rules of some forums, such actions might be joined in order to avoid multiplicity of actions or for other reasons; but the text of this article is intended to prevent the possibility of State X being sued, merely because it became a complainant, in an action which otherwise could not be maintained against it by the respondent and which action, moreover, is based on claims arising out of matters extrinsic to those on which the original claim of the complainant State is based, and, therefore, not in the nature of a defense to the complainant's action."

It becomes apparent, therefore, that two prerequisites must exist before an indirect counterclaim (or what under the Federal Rules is termed a permissive counterclaim), may be pleaded against a foreign state. The first prerequisite is purely a matter of local procedure; unless the procedural law permits indirect counterclaims to be pleaded against private ligitants in general, then the counterclaim claimed is not entertainable, not because a sovereign is involved, but because the procedural laws prohibit its being pleaded. On the other hand, if the procedural laws permit indirect counterclaims, the second prerequisite, which deals with matters of substantive law, must be complied with. Jurisdiction exists over the counterclaim treating it as an independent proceeding, but if the sovereign's separate consent thereto is lacking, the counterclaim must be dismissed.

The Principle Requiring a Sovereign Plaintiff to Conform to Procedural Rules of the Forum Cannot Be Relied Upon to Furnish Consent to Litigate a Claim or to Make an Unenforceable Claim Enforceable.

A sovereign by becoming a litigant subjects itself to the rules of procedure of the forum only so far as they are applicable to the particular cause of action which is the subject matter of the litigation, and even that is a limited principle. Thus, it would have to post security, pay costs, submit to discovery and to an oral examination.[30] But even petitioner does not contend that a sovereign by becoming a litigant subjects itself to the rules of procedure with respect to judgments and execution thereon even with regard to the subject matter of the suit to which it has consented. Nor, it is submitted, are the ordinary rules of procedure dealing with counterclaims unrelated to the main suit applicable to a sovereign plaintiff who has not consented to suit on that independent claim. Certainly a sovereign who becomes a litigant by appearing voluntarily as a defendant in a suit against it on a particular claim is not subject to further unrelated claims merely because the rules of procedure ordinarily permit a plaintiff to amend his complaint to include new causes of action.

Where a sovereign becomes a litigant, whether as plaintiff or defendant, the procedural rules determine merely if the subsequent inclusion in the litigation of new causes of action are permissible, provided the sovereign also consents to suit thereon. The consent of the sovereign is required before an enforceable claim comes into being. But even the sovereign's consent to have the new cause of action also

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[30] *Guaranty Trust Co.* v. *U. S.*, 304 U. S. 126, and cases cited therein. In the *Guaranty* case, the procedural rule of limitation of time to sue was applied to the particular cause of action sued upon.

litigated in that suit (whether it is a defendant and the complaint is sought to be amended to include an independent cause of action, or if it is a plaintiff and defendant wishes to counterclaim on unrelated causes of action) would not make the claim one which could be litigated in the particular suit unless, in addition to the sovereign's consent, the procedural rules of the forum permit the new claim to be litigated in the original suit. Conversely, the procedural rules permitting litigation on claims unrelated to the original suit do not make the claim an enforceable one unless the sovereign gives its consent to that particular claim.

It matters not, therefore, that Rule 13(b) of the Federal Rules provides that "permissive counterclaims" arising from transactions unrelated to the main suit may be pleaded by a defendant. The rules of procedure merely permit the joining of separate and independent claims in one proceeding to avoid a multiplicity of suits, provided, of course, that the court has jurisdiction over the unrelated claim and that the unrelated claim as a matter of substantive law is an enforceable one. Rule 82 of the Federal Rules explicitly states that nothing therein contained shall be construed to enlarge or diminish the jurisdiction of the court. The doctrine that a court will not exercise jurisdiction over a foreign sovereign existed long before the Federal Rules were promulgated, and by virtue of Rule 82 nothing in the Rules may be relied upon to affect the exercise of the Court's jurisdiction.

In *U. S.* v. *Sherwood*, 312 U. S. 584, this Court ruled that where the sovereign had not independently consented to a particular suit, the consent could not be supplied by the Federal Rules.[31] After stating the general rule that the United States as sovereign is immune from suit save

[31] See also *Urate* v. *U. S.*, 7 F. R. D. 705.

as it consents to be sued (at p. 586), the Court stated (at pp. 589-590):

> "But we think that nothing in the new rules of civil practice so far as they may be applicable in suits brought in district courts under the Tucker Act authorizes the maintenance of any suit against the United States to which it has not otherwise consented. An authority conferred upon a court to make rules of procedure for the exercise of its jurisdiction is not an authority to enlarge that jurisdiction; and the Act of June 19, 1934, 48 Stat. 1064, 28 U. S. C. 723b, authorizing this Court to prescribe rules of procedure in civil actions gave it no authority to modify, abridge or enlarge the substantive rights of litigants or to enlarge or diminish the jurisdiction of federal courts."

And at page 591:

> "The matter is not one of procedure but of jurisdiction whose limits are marked by the Government's consent to be sued. That consent may be conditioned, as we think it has been here, on the restriction of the issues to be adjudicated in the suit, to those between the claimant and the Government. The jurisdiction thus limited is unaffected by the Rules of Civil procedure, which prescribe the methods by which the jurisdiction of the federal courts is to be exercised but do not enlarge the jurisdiction."[32]

In sum, if the indirect or permissive counterclaim is not one upon which an independent proceeding could have

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[32] The result in *U. S.* v. *Yellow Cab Co.*, 340 U. S. 543, is perfectly consistent with the *Sherwood* case. In the *Yellow Cab* case the Court first determined that the statute involved gave independent consent by the sovereign to be sued for contribution. The consent having been found in that statute, the question of whether it could be joined in the suit was purely one of procedure. Moreover, the statute granting the consent explicitly provided that the Federal Rules were to control.

been brought against the Sovereign, then it may not be pleaded as a matter of substantive law.[33] In this respect, whether the policy of immunity is based on comity or on the inherent lack of jurisdiction of the Court,[34] it is clear that it is "an over-riding principle of substantive law."[35]

It is significant that petitioner has not cited one authoritative decision which has permitted a permissive counterclaim or set-off against a sovereign without its consent thereto or which has even implied that such a counterclaim could be asserted. *State of Russia* v. *Bankers Trust Company*, 4 F. Supp. 417, cited by petitioner at pp. 13-14 of its brief, was affirmed sub nom. *United States* v. *National City Bank of New York*, 83 F.(2) 236, cert. denied 299 U. S. 563, in which the Court of Appeals rejected the lower court's reasoning and affirmed solely on the ground the set-off was related to the main suit. *The Gloria, The Thekea, etc.* v. *Federal Sugar Refining Co.*, 286 Fed. 188, cited by petitioner on page 30 of its brief, resulted in questions being certified by the Court of Appeals for the Second Circuit in 295 Fed. 1020, and in the questions being answered by this Court in 266 U. S. 328. This is the same *Thekea* case which petitioner discusses on page 16 of its brief for the proposition that, when a sovereign sues in our courts to enforce a claim in admiralty, "it so far takes the position of a private suitor as to agree by implication that justice may be done *with regard to the subject matter.*" 266 U. S. 328, 339-340. The quotation in petitioner's brief (p. 30) from *People* v. *Brandreth*, 36 N. Y. 191, is from the dissenting opinion.

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[33] The position is also adopted by the Harvard Draft Convention. See Article 14 and comments thereon, Am. J. of Intern. Law Supp. (1932) at p. 646.

[34] *Yokohama Specie Bank* v. *Chengting T. Wang*, 113 F. (2) 329, 331, cert. denied 311 U. S. 690; *Wulfsohn* v. *Russian Republic*, 234 N. Y. 372, 376.

[35] *Ex Parte Peru*, 318 U. S. 578 at p. 588.

POINT III.

THE COUNTERCLAIMS ASSERTED DO NOT ARISE OUT OF THE SAME TRANSACTION OR SUBJECT MATTER OF THE SUIT.

There is no merit to petitioner's argument that its counterclaims are actually compulsory counterclaims within Rule 13(a) of the Federal Rules and are tantamount to pleas of recoupment assertible as a defense to the sovereign's suit even without its consent. We fail to see any logical relationship between a Treasury note issued in 1920 to secure a loan to the Pacific Development Company for the economic rehabilitation of China and Short Term Treasury notes or bonds purchased by petitioner in China in 1947 and 1948 on the one hand, and on the other hand the bank deposit which was opened in the name of respondent's agency The Shanghai-Nanking Railway Administration. Petitioner itself treated the bank deposit and the Treasury notes as separate obligations, as evidenced by its allegations that no debit of any kind has been made to the account except for a $7.50 service charge, and that the account is now in credit of $199,992.50 (R. 13-14).

A holding that these are compulsory counterclaims means that, unless pleaded, petitioner would have been foreclosed from ever suing thereon. But surely in a suit by a private party to recover a bank deposit, *res adjudicata* would not prevent a bank from asserting in a later independent suit a claim on unpaid notes. Since the facts on which petitioner relies for relief can nowhere be found in respondent's complaint and are quite distinct from the facts there set forth, the counterclaims can not be considered as compulsory counterclaims or mere pleas of recoupment.

Nor is there any substance to the contention, "as one of the grounds for sustaining the counterclaims, that they were payable at the City Bank, and that, therefore, under decided cases and pursuant to §147 of the Negotiable Instruments Law of the State of New York[36], they should be considered as a direction to pay the obligee to the extent of the bank account sought to be recovered in the action." (Petitioner's brief, p. 31). That Section is clearly inapplicable, inasmuch as each of the obligations alleged in petitioner's counterclaims are *not* payable in New York at petitioner's bank where the deposit is located, as petitioner admits. The Treasury note alleged in the first counterclaim is payable at The Chase National Bank (R. 53), of no affiliation whatsoever with petitioner. Similarly, with respect to each of the Treasury notes alleged in the second counterclaim, petitioner admits that they were not purchased by or payable at its bank in New York where the funds respondent is suing for are deposited, but that each was purchased by its Shanghai branch (R. 25) and is payable at The Central Bank of China or its agents, one of which petitioner asserts was its Shanghai branch[37] (R. 33, 53).

Plainly, under the Section relied upon, a New York bank which holds a deposit cannot use the deposit funds to satisfy a Treasury note not payable in New York or payable at some other bank.

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[36] Section 147 of the New York Negotiable Instruments Law provides: "Where the instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon."

[37] It passes understanding how petitioner can properly contend that the provisions of the New York Negotiable Instruments Law are applicable to government Treasury notes executed in China and made payable in China.

POINT IV.

THE PLEA OF SOVEREIGN IMMUNITY TO THE COUNTERCLAIMS IS NOT IN CONFLICT WITH THE SUGGESTED CHANGE IN POLICY OF THE STATE DEPARTMENT TO RESTRICT THE DOCTRINE OF SOVEREIGN IMMUNITY TO ACTIVITIES CONNECTED WITH PUBLIC OR GOVERNMENTAL ACTS. FURTHERMORE, A SHIFT IN POLICY BY THE EXECUTIVE DEPARTMENT CANNOT CONTROL THE COURTS.

Petitioner's assertion that this Court should follow the restrictive theory of sovereign immunity in this case should be disregarded by the Court because of the contrary position taken by petitioner in the Court of Appeals. In its brief to the Court of Appeals petitioner admitted that the obligations alleged in both counterclaims represented loans for the "economic" rehabilitation of China, and it conceded in its oral argument that, even within the restricted views of the State Department as expressed in Mr. Tate's letter, respondent would be entitled to plead sovereign immunity to the causes of actions alleged in the counterclaims. This appears from the opinion of the Court of Appeals itself, where it said (R. 68):

> "Defendant, as we understand it, does not argue that this new trend, if adopted by our courts, would here serve to deprive plaintiff of its sovereign immunity."

Petitioner should not be permitted to shift its position in this Court by now urging that the restrictive theory, if adopted by our courts, would here serve to deprive respondent of its sovereign immunity.

But assuming the question is properly before the Court, we submit that the prior decisions of this Court, wherein the restrictive theory was considered and rejected, are bind-

ing precedents which should be followed. The decisions of some civil law countries contained in petitioner's brief are hardly persuasive on what the law is in the United States.

In *Federal Crop Ins. Corp.* v. *Merrill,* 332 U. S. 380, this Court noted that (at p. 383):

> "It is too late in the day to urge that the Government is just another private litigant, for purposes of charging it with liability, whenever it takes over a business theretofore conducted by private enterprise or engages in competition with private ventures."

Civil law cases "holding foreign states subject to their jurisdiction whenever the foreign states are acting, as it is phrased, not in sovereign or political capacity (*jure imperii*) but as subjects of civil rights (*jure gestionis*)", were noted by Judge Mack in *The Pesaro,* 277 Fed. 473, 484, wherein he denied the claim of immunity because the Government vessel was engaged in commercial enterprise. This Court, however, reversed this decision (*Berizzi Bros.* v. *SS. Pesaro,* 271 U. S. 562), thereby rejecting the restrictive theory. This view was affirmed in *Compania Espanola* v. *The Navemar,* 303 U. S. 68, 74.

The doctrine of sovereign immunity is too deeply embedded in our law to be uprooted by judicial decision. This seems particularly appropriate in the instant suit, which is based upon specific legislation (Section 25-b of the Federal Reserve Act), the benefits of which Congress could, but did not, condition upon the sovereign's waiver of immunity. If the doctrine is to be modified, any change in the substantive law permitting territorial jurisdiction to be exercised even to a limited degree should be made by Congress[38] through an express legislative pronouncement, or by

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[38] *Cf: Halycon Lines* v. *Haenn Ship Corp.,* 342 U. S. 283, 285; *U. S.* v. *Atlantic Mut. Ins. Co.,* 343 U. S. 236, 242.

treaty.[39] Certainly the lack of unanimity among nations as to the restrictive theory seems to compel such a course. As Mr. Tate's letter indicates, there are at least sixteen countries, including the United States and the British Commonwealth, that have not applied the restrictive theory, as opposed to possibly eleven civil law countries that have followed it. Furthermore, because of the lack of reliance in civil law countries upon *stare decisis*, their decisions can not be cited for binding precedents. That the problem is one for multilateral convention or treaties is recognized by the State Department.[40] Indeed, it appears that the State Department, where it has sought to exclude sovereign immunity from commercial activities, has done so by treaty. However, there is no treaty with respondent waiving its sovereign immunity.

Moreover, international comity requires that foreign governments be notified of any modification of immunity in a manner not to be misunderstood. Mr. Chief Justice Marshall, in *The Schooner Exchange* v. *McFadden*, 7 Cranch 116, 146 (quoted with approval in *Berizzi Bros.* v. *SS. Pesaro*, 271 U. S. 562, 564) took care to point out that "Without doubt, the sovereign of the place is capable of destroying this implication, * * * But until such power be exerted in a manner not to be misunderstood, the sovereign cannot be considered as having imparted to the ordinary

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[39] The Maipo, 259 Fed. 367, 368 (per Judge Hough).

[40] See p. 2 of foreword to State Department's treatise on "The Law of Sovereign Immunity" (referred to *supra*, f. n. 9) where it is said: "In view of the fundamental differences in basic concepts suggested above, it is important to give careful attention to the possibility of resolving the whole matter by multilateral convention * * *"; also p. 13 of that portion of the treatise dealing with Common Law Countries. Cf. Brandon, The Case Against the Restrictive Theory of Sovereign Immunity (1954), 21 Insurance Counsel Journal, 11 at p. 15.

tribunals a jurisdiction, which it would be a breach of faith to exercise." It is submitted that this can be accomplished only by treaty.

The Counterclaims Relate to Public Funds and Therefore Are *Jure Imperii* Within the Restrictive Theory.

Both counterclaims embrace Treasury notes which relate to the fiscal operations of a sovereign. The counterclaims, therefore, deal with governmental or public acts, so that even within the restrictive theory respondent may plead immunity. Like its currency, Treasury notes and bonds are issued by virtue of the sovereign power. Interruption in payments thereof occur solely by virtue of the sovereign authority of the state, an act *jure imperii*.

Courts in this country and also in England have consistently held that debts due from a foreign nation in the nature of bonds cannot be enforced in the creditor nation. *Bank of Washington* v. *State of Ark.*, 20 How. 530; *Monaco* v. *Mississippi*, 292 U. S. 313; *U. S.* v. *Securities Corp. General*, 4 F.(2) 619, at p. 622, affirmed 269 U. S. 283. In *Twycross* v. *Dreyfus* (1887), 36 Law Times Report 752 the Court of Appeals remarked at page 755:

> "The result, therefore, is that these so-called bonds amount to nothing more than engagements of honour, binding, so far as engagements of honour can bind, the government which issues them, but are not contracts enforceable before the ordinary tribunals of any foreign country, or even by the ordinary tribunals of the country which issued them, without the consent of the government of that country. That being so, it appears to me that the bond in question confers no right of action on the plaintiffs, and on that ground it follows that the demurrer ought to be allowed. * * *"

And in *Hannes* v. *Kingdom of Roumania M. Institute*, 169 Misc. (N. Y.) 544 at p. 545:

> "Particularly universal is the rule obtaining in international law that when a question of the public debt of a sovereign nation is involved, the shield of immunity from suit in the courts of a foreign nation is impenetrable."

Furthermore, the treaties which the State Department has concluded with foreign countries (Petitioner's brief, pp. 44-45) do not embrace fiscal operations of a sovereign such as are here involved, but the treaties apply merely to "* * * business activities within the territories of the other Party * * *".

The Harvard Draft Convention in Article 11 accepts the restrictive theory of immunity. The comment to the Article (Am. J. Intern. Law Supp. (1932) at p. 609) recognizes that, even if the principle is accepted, "it is difficult to set up a standard for distinguishing between the two classes of acts", that in which the state acts either jure imperii or jure gestionis. However, special precaution was taken with respect to one type of activity, viz., public funds. Article 11 concludes with a specific paragraph "The foregoing provision shall not be construed to allow a State to be made a respondent in a proceeding relating to its public debt", and the comment to the Article defines "public debt" explicitly to include Treasury notes of a sovereign.

CONCLUSION.

That one cannot litigate a claim against a sovereign does not mean he is foreclosed from collecting on a valid claim, but only that he must resort to diplomatic channels. Surely petitioner when dealing with foreign governments recognizes and considers these calculated risks which are

not present in ordinary business transactions between individuals. "* * * when one knows with whom he is dealing and the law applicable, he must arrange accordingly". *The Maipo*, 252 Fed. 627, 630.

Petitioner must rely on the good faith and honor of respondent. For almost twenty years the National Government of China has been through one national crisis after another, and it has been compelled to fight and is still fighting for its very existence. But at no time has respondent repudiated any of its just obligations.

It would be an unfortunate rule that would allow a bank to set off Treasury notes against funds of a sovereign deposited with the bank. Financial distress of an obligor usually results in his obligations being sold at discount. Banks able to buy government notes on the open market at prices below their face value would have an opportunity to convert the government deposit into a substantial profit. But more important, when dealing with a sovereign in times of crisis a bank knows that a deposit when opened is for the specific purpose of having funds available to meet the sovereign's current emergency needs.

The United States, by waiving its immunity from suits on certain transactions, may set an example for other nations to follow voluntarily. But certainly for the United States to force its concepts on other countries would be inconsistent with its own democratic principles. Thus, it is one thing for Congress to enact a statute waiving the immunity of the United States from set-offs unrelated to the main suit; it is another thing for this Court to hold that foreign countries suing in United States courts must meet the standard Congress has prescribed for the United States. Moreover Congress, when it enacted Section 25-b of the Federal Reserve Act, could have conditioned its benefits on compliance by the foreign sovereign with the

standards Congress had prescribed for the United States, but it did not do so.

It is significant that the Harvard Draft Convention, which resulted from a careful study by eminent scholars on international law, reached conclusions contrary to petitioner's main contentions: indirect counterclaims including set-offs are not pleadable against a sovereign plaintiff unless independent proceedings thereon against the sovereign can be maintained (Article 6); the rules of procedure of the forum cannot vary that principle (Article 14), and a sovereign cannot be made to litigate, whether by direct suit, indirect counterclaim or set-off, matters relating to its public debt. (Article 11).

In addition to the well-established reasons for sovereign immunity set forth in *U. S.* v. *Shaw,* 309 U. S. 495, 501, one of the most persuasive reasons for the recognition of the doctrine in this case is that a sovereign, in order to exist, must have complete control over its fiscal affairs. It must be in a position to decide when and how its indebtedness is to be paid, particularly in times of national crisis. The sovereign immunity that flows from this necessity and protects the government is as essential to the modern republic as it was to the ancient monarch. While a sovereign may waive this protection so far as suits against itself are concerned, or it may be removed by treaty or by international agreement, the right is too important and too well recognized to be destroyed or modified by the judiciary.

Assuming that the question is properly before the Court, and stripped of all but the essential, the controlling issue really is whether the National Government of the Republic of China has consented to be sued for a part of its national indebtedness. We submit that it has not, and that petitioner must resort to the normal channels of international negotiation for the payment of its claims.

The writ of certiorari should be dismissed as improvidently granted, or in the alternative the order of the Court of Appeals should be affirmed.

Respectfully submitted,

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October 6, 1954.

APPENDIX.

The third and last paragraphs of Section 632 of Title 12, U. S. Code, popularly known as Section 25(b) of the Federal Reserve Act, read as follows:

"§ 632. JURISDICTION OF UNITED STATES COURTS; DISPOSITION BY BANKS OF FOREIGN OWNED PROPERTY.

"* * *

"* * *

"Whenever (1) any insured bank has received any property from or for the account of a foreign state which is recognized by the Government of the United States, or from or for the account of a central bank of any such foreign state, and holds such property in the name of such foreign state or such central bank; (2) a representative of such foreign state who is recognized by the Secretary of State as being the accredited representative of such foreign state to the Government of the United States has certified to the Secretary of State the name of a person as having authority to receive, control, or dispose of such property; and (3) the authority of such person to act with respect to such property is accepted and recognized by the Secretary of State, and so certified by the Secretary of State to such insured bank, the payment, transfer, delivery, or other disposal of such property by such bank to or upon the order of such person shall be conclusively presumed to be lawful and shall constitute a complete discharge and release of any liability of such bank for or with respect to such property. Any suit or other legal proceeding against any insured bank or any officer, director, or employee thereof, arising out of the receipt, possession, or disposition of any such property shall be deemed to arise under the laws of the United States and the district courts of the United States shall have exclusive jurisdiction thereof, regardless of the amount involved; and any such bank or any officer, director, or employee thereof which is a defendant in any such suit may, at any time before trial thereof, remove such suit from a

State court into the district court of the United States for the proper district by following the procedure for the removal of causes otherwise provided by law.

"* * *

"For the purposes of this section, (1) the term "property" includes gold, silver, currency, credits, deposits, securities, choses in action, and any other form of property, the proceeds thereof, and any right, title, or interest therein; (2) the term "foreign state" includes any foreign government or any department, district, province, county, possession, or other similar governmental organization or subdivision of a foreign government, and any agency or instrumentality of any such foreign government or of any such organization or subdivision; (3) the term "central bank" includes any foreign bank or banker authorized to perform any one or more of the functions of a central bank; (4) the term "person" includes any individual, or any corporation, partnership, association, or other similar organization; and (5) the term "insured bank" shall have the meaning given to it in section 264 of this title. Dec. 23, 1913, c. 6, §25(b), as added June 16, 1933, c. 89, §15, 48 Stat. 184, and amended Apr. 7, 1941, c. 43, §2, 55 Stat. 131."